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Treasury Committee

Budget 2014: Government and OBR Responses to the Committee's Thirteenth Report of Session 2013–14

Second Special Report of Session 2014–15

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Second Special Report

The Committee published its Thirteenth Report of Session 2013–14, *Budget 2014*, on 7 May 2014, as House of Commons Paper No. 1189. The Government Response was received on 7 July 2014 and the Office for Budget Responsibility Response was received on 16 June 2014.

The Government Response is in plain text and the Committee's conclusions and recommendations are in bold text. It is attached as appendix 1. The OBR Response is attached as appendix 2.

Appendix 1: Government Response

Introduction

1. It is regrettable that the Government did not supply details of its additional support for childcare to the OBR in time for it to verify the Government's claims about the costs of this policy. The OBR has said that it will look at this measure closely in the run up to the Autumn Statement. It is not acceptable, however, that the Government's figures should be left unverified for what may be more than eight months. We recommend that, when Budget announcements are not submitted before the OBR's deadline, the OBR should scrutinise major uncosted policies as soon as reasonably possible thereafter and publish its findings. (Paragraph 7)

As part of the Tax-Free Childcare consultation published in August 2013 the Government also consulted on policy changes to childcare within Universal Credit. In March 2014 the Government set out a commitment to increase support within Universal Credit with further details to be set out in due course, including DWP's own response to the original consultation.

Costings for all policies announced since the OBR's Budget deadline will be scrutinised by the OBR in the usual way prior to Autumn Statement, including the costs for the additional support for childcare through Universal Credit, once the Department for Work and Pensions has published its consultation response. The Government will publish details of the methodology and key assumptions in the costing at Autumn Statement, alongside offsetting savings.

2. We welcome the fact that the Government maintained the confidentiality of the Budget this year. This can only have helped the presentation of the Budget measures. This Budget was unusual, however, in that one of its most important components—the reform of pensions—was highly market sensitive: the rules against selectively disclosing market sensitive information appear to have constituted a powerful enough deterrent to advance briefing of those reforms. We will expect this year's good practice in maintaining confidentiality to be maintained in future Budgets, when such considerations do not necessarily apply. (Paragraph 10)

All briefing on Budget measures to the press and public stakeholders was conducted in strict adherence to the recommendations adopted in the Treasury's Review into the pre-release of Budget information, led by the Permanent Secretary of the Treasury Sir Nicholas Macpherson, published in July 2013. On the recommendation of this review, the Treasury introduced a ban on the pre-release of the core of the Budget (and Autumn Statement), that is: the economic and fiscal projections, the fiscal judgement and individual tax rates, reliefs and allowances. The Government will continue to adhere to this procedure in future fiscal events and has also agreed that future briefing arrangements for the Budget (and Autumn Statement) are only changed with the Chancellor's explicit agreement on the recommendation of the Permanent Secretary of the Treasury.

Macroeconomy

3. House price and commercial real estate bubbles are easy to spot in retrospect. The problem for the Financial Policy Committee is to spot them in advance of their bursting and take whatever action is required to mitigate their negative effects on financial stability. (Paragraph 54)

4. Wider economic concerns are the responsibility of the Government and the Monetary Policy Committee. The Government is also responsible for fiscal and policy tools which directly influence the housing market. It should therefore state what indicators it believes are most important in detecting any wider economic risks arising from the housing market. It should also set out how it plans to address these risks, should they arise. (Paragraph 55)

A failing of the Tripartite regulatory system designed by the previous Government was the fact that no single institution was responsible for monitoring the financial system as a whole, identifying potentially destabilising trends and responding to them with concerted action. That is why the Government created the Financial Policy Committee (FPC) within the Bank of England to ensure emerging risks and vulnerabilities across the financial system as a whole are identified, monitored and effectively addressed. The FPC looks at a number of indicators across the economy, including those which have proved helpful in identifying emerging risks to financial stability in the past, monitoring them closely and paying attention to the housing market in collaboration with the Monetary Policy Committee. As the FPC has made clear, "No single set of indicators can ever provide a perfect guide to systemic risks, or to the appropriate policy responses ... Judgement will play a material role in all FPC decisions".

With regard to risks from developments in the housing market and household indebtedness, in its November 2013 Financial Stability Report the FPC said it, "will closely monitor:

- developments in house price inflation relative to indicators of affordability and sustainability;
- indicators of an increasing 'tail' of borrowers with particularly high indebtedness;
- indicators of underwriting standards in the residential mortgage market;
- indicators of underwriting standards on construction and CRE loans;

- exposure of lenders to highly indebted households; and
- the reliance of lenders on short-term wholesale funding."

The FPC's June 2014 Financial Stability Report includes the Committee's latest assessment of the outlook for financial stability. While the FPC judged that household indebtedness does not pose an imminent financial stability risk, it made two policy recommendations aimed at insuring against the risk of a marked loosening of mortgage underwriting standards and a further significant rise in the number of highly indebted households:

- When assessing affordability, mortgage lenders should apply an interest rate stress test that assesses whether borrowers could still afford their mortgages if, at any time over the first five years of the loan, Bank Rate were to be 3 percentage points higher than the prevailing rate at origination; and
- The Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA) should limit the proportion of mortgages at loan to income multiples of 4.5 and above to no more than 15% of their new mortgages.

5. The Chancellor has asked the FPC to be "particularly vigilant against the emergence of potential risks in the housing market". It is not clear precisely what this means in practice, since the new remit document endorses the existing levels of vigilance. The Chancellor should provide a more detailed explanation of his comment, and whether he expects the FPC to interpret its remit in a way that might prompt it to take further action as a consequence. (Paragraph 56)

The Bank of England Act 1998, as amended by the Financial Services Act 2012 (the Act), requires the Treasury, on an annual basis, to specify what the economic policy of the Government is and to make recommendations to the FPC about matters that the Committee should regard as relevant to the Committee's understanding of the Bank's financial stability objective and the Committee's responsibility in relation to the achievement of that objective. The Act also empowers the Treasury to make written recommendations to the Committee about its responsibility in relation to support for the Government's economic policy, as well as matters to which the Committee should have regard in exercising its functions.

The 2014 Remit and recommendations for the FPC noted that a sustainable recovery in the housing market will only be secured if lenders continue to lend responsibly and borrowers do not take on unaffordable commitments, and emphasised the importance of the FPC remaining vigilant as the recovery progresses. Consistent with its statutory objectives and with the recommendations in the Remit, it is for the Committee to monitor developments in the housing market with a view to assessing whether and, if so, when it may be necessary to take action to address emerging risks to financial stability. As noted in the answers to questions 3 and 4, above, the FPC concluded in its June 2014 Financial Stability Report that household indebtedness does not pose an imminent financial stability risk, but it made two policy recommendations aimed at insuring against the risk of a marked loosening of mortgage underwriting standards and a further significant rise in the number of highly indebted households.

6. The evidence we took concurred with the view of the OBR that the recovery to date has been driven by an increase in demand without a corresponding rise in supply potential. The output gap is being reduced in size and, so far, there is insufficient evidence to support the view that productivity growth is returning. (Paragraph 65)

At Budget 2014 the OBR judged that in Q4 2013 the economy was operating slightly closer to full capacity than they thought in December 2013, reflecting the view that there was less slack in the labour market. Going forward, the OBR forecast a stronger recovery than at Autumn Statement 2013. As a result, the economy will return to operating at full capacity around a year earlier.

The latest estimates of the GDP growth show continuing signs of momentum in the economy. Data for the first quarter of 2014 showed that the recovery is balanced across all the main sectors of the economy, with manufacturing, services and construction all growing compared to the same quarter a year earlier. Business investment increased by 5.0 per cent in Q1 2014, now growing for five consecutive quarters for the first time since 1998. This reflects the OBR forecast which predicts a transition from recovery driven by household consumption to one with a more even balance between consumption and investment.

The OBR forecast the potential productivity growth, which underpins the sustainability of the recovery, to accelerate to 2.0 per cent by 2017, reflecting the normalisation of financial markets over the forecast horizon. The actual productivity growth is forecast by the OBR to turn positive this year and rise by over 2.0 per cent from 2015 onwards. This will allow the pace at which resources are allocated to more productive uses to pick up. The latest outturn figures for Q1 2014 provide evidence of continued growth in productivity, with output per hour growing by 0.4 per cent on a year ago, and output per worker up by 0.6 per cent.

The public finances

7. For the fourth Economic and Fiscal Outlook in a row, the OBR forecasts that the Government will meet the rolling fiscal mandate, but not the supplementary target. In line with previous occasions, the Government has not proposed any corrective action in order to meet the supplementary target. Instead the Government has allowed the automatic stabilisers to continue their work, rather than taking corrective action—tightening fiscal policy—in order to meet the supplementary target. (Paragraph 70)

The Government's fiscal strategy is underpinned by a forward-looking fiscal mandate to achieve cyclically-adjusted current balance by the end of a rolling, 5-year forecast period. The OBR forecast that the Government remains on course to meet the mandate a year early, in 2017–18. In addition, the OBR forecasts that, on its underlying measure of public sector net borrowing, in 2018–19 the Government will run its first surplus for 18 years.

The fiscal mandate is supplemented by a target for public sector net debt (PSND) as a percentage of GDP to be falling in 2015–16. The OBR forecast that PSND as a percentage of GDP will be falling in 2016–17, a year later than set out in the supplementary debt target. This is due to the ongoing effects of the financial crisis, combined with economic headwinds from the euro area and higher commodity prices, which has meant that economic growth in the past few years has not been as high as originally forecast.

The Government took the decision to allow the automatic stabilisers to complement active monetary policy in supporting the economy. This approach was enabled by the credibility earned through its medium-term consolidation plan. Whilst allowing the automatic stabilisers to operate, the Government has stuck to its economic plan and as a result debt as a percent of GDP will be falling in 2016–17. The Government remains committed to tackling Britain's long-term debt challenge. Both parties of the coalition agree that, once the supplementary debt target has been met, debt should continue to fall as a percentage of GDP. However, despite progress made since 2010, the record deficit inherited by this Government means that public sector net debt will peak at its highest level since the late 1960s at 78.7 per cent of GDP in 2015–16.

There has been an improvement in the OBR's forecast for PSND since both Autumn Statement and Budget 2013. PSND will peak 1.2% of GDP lower than at Autumn Statement 2013 and 6.8 per cent of GDP lower than forecast at Budget 2013, when debt was forecast to peak in 2016–17.

8. The Budget was fiscally neutral on a five year view—the forecast period. Four of the measures announced have consequences within the forecast period that differ significantly from their longer term effects. These measures are fiscally positive within the five year forecast period. However, this tapers and they are projected to be fiscally negative after 20 years. While the effect of these four spending decisions may be small, and subject to uncertainty, the Committee would be concerned if the Government made fiscal decisions with its eye only on the five year forecast period. It is important that the OBR cost the long term implications of Budget measures. (Paragraph 78)

At fiscal events, the Government considers the long term fiscal impact of policies as part of its decision making process. Budget 2014 set out the projected 25 year impact of the measures introduced to provide greater flexibility and choice to defined contribution pensions including the projected impact on tax revenues. The Budget also showed these impacts in the context of wider pensions policy introduced by this Government. This showed that the net impact is a saving to the Exchequer of around 1.1% of GDP in 2030, or around £17 billion in today's terms, putting pensions provision on a more sustainable basis for the long term.

9. After an economic shock, cyclically adjusted measurements are particularly uncertain. The current fiscal mandate is dependent on an unobservable output gap. It has been made even more unreliable as a consequence of the financial crisis. (Paragraph 83)

10. For most of the last 30 years, governments have been trying to devise a robust fiscal anchor. There have been successive Medium Term Financial Strategies; the Code for Fiscal Stability (modified during the crisis by the temporary operating rule); and the Charter for Budget Responsibility. The Government is now considering a new Charter for Budget Responsibility. Fiscal anchors have merit. But at a time when the credibility of pledges in all aspects of public policy has attracted greater scepticism than before, it will be more difficult to build confidence in the fiscal anchor deep enough to withstand an extreme event. (Paragraph 84)

The UK's fiscal policy framework requires the Government to set out its fiscal policy objectives and fiscal mandate before Parliament in the *Charter for Budget Responsibility*. As set out in the Charter the fiscal mandate will lapse at the end of this Parliament.

The Government has made significant progress in dealing with the deficit, which is forecast to have halved as a percentage of GDP by 2014–15. In Budget 2010 the Government said it would revisit the future of the fiscal framework once the public finances were closer to balance.

The Government is therefore reviewing the fiscal framework this year. This review is considering several questions, including:

- What is the appropriate time horizon for the fiscal mandate once the structural current deficit is closer to balance?
- How could fiscal credibility be further enhanced by a stronger Parliamentary commitment to the path of consolidation in 2016–17 and 2017–18?

The outcome of the review will inform an updated *Charter for Budget Responsibility* which will be presented to Parliament alongside Autumn Statement 2014.

11. Ring fencing distorts spending decisions. It also weakens rigorous scrutiny of spending in ring fenced departments. Furthermore, with each year that ring fencing remains in place, the size of ring fenced departments increases as a proportion of total departmental spending. The IFS has stated that by 2015–16, expenditure reductions of 21 per cent will have been implemented in areas other than the NHS, schools and overseas aid. Each successive round, seeking reductions from an already smaller non-ringfenced base, will be more difficult than its predecessor. (Paragraph 89)

The Government has had to take tough decisions in order to bring down the deficit. As a key part of this, the Government set out plans in 2010 to reduce spending by £80bn over the Spending Round 2010 period, and by a further £11.5bn at Spending Round 2013, while simultaneously prioritising the vital public services that everyone relies on at home, and supporting the poorest overseas.

As part of these spending reductions, the Government has committed to increase efficiency and cost-effectiveness across all areas of public spending, including those that have been protected from headline reductions. The Government expects to deliver £20bn of efficiency from central departments over the five years to 2014–15.The Government is also focused on increasing the efficiency of the wider public sector; the NHS, for example, is on course to deliver up to £20bn of savings by 2015 through the QIPP (Quality, Innovation, Prevention and Productivity) efficiency programme.

Specific decisions on composition of spending consolidation beyond 2015–16 are for the next Spending Review, but the IFS assumes that all further spending consolidation will be delivered through departmental budgets alone.

12. 17 per cent of headline total managed expenditure in 2012–13 would have been covered by the welfare cap. The cap raises a number of concerns and we intend to seek further written evidence on its design and operation. Some welfare spending is not included within the cap. This may distort decision making, for example by tempting a

government to change welfare entitlements in order to avoid breaching it. The penalty for a breach of the cap is any political embarrassment that may come with Parliamentary debate, a requirement in the event of its breach. The cap is therefore declaratory. Previous examples of such declarations include the child poverty target and the fuel poverty target. (Paragraph 105)

The Government welcomes the Committee's interest in the welfare cap. The Charter for Budget Responsibility sets out the scope of the cap and the accountability mechanisms that underpin it. Jobseeker's Allowance (JSA) and Housing Benefit (HB) paid to jobseekers has been excluded because these payments are the most counter-cyclical and the Government wishes to continue to allow the automatic stabilisers to function. The Government believes that State Pension expenditure is better controlled through a separate automatic mechanism that links the state pension age to longevity. The Government will seek the approval of the House of Commons before changing the level of the cap or changing its scope. The Government has asked the OBR to publish an annual report on trends in and drivers of welfare spending so that an informed debate can be held about any action on welfare spending.

Pension reforms and savings

13. The Committee notes that all witnesses welcomed the greater flexibility and choice provided by the Government's proposed pension reforms. We further note the Chancellor's commitment to "free, impartial, face-to-face advice", which will be important for many people for the reforms to work. (Paragraph 118)

14. The full impact of the pension reforms on the long-term social care budget remains uncertain. The Government is right to require the long-term care means test to be revised in the light of these reforms. The Government has an understandable desire to have the radical changes to pensions completed as soon as possible. Because the reforms both to pensions and to long-term care come into force simultaneously, the revision of the long-term care means test should be completed in time for those who may be affected by both these reforms to make informed choices. (Paragraph 132)

The current rules on eligibility for social care funding were not written to account for these pension flexibilities. The Government is already committed to considering new financial services products when reviewing and developing new guidance and regulations on charging for care. It is not our intention that someone's eligibility for social care support should be affected simply because they purchased certain flexible pensions products as alternatives to annuities. We will ensure that, where necessary, appropriate updates are in place for the start of the new flexibilities in April 2015.

15. Until now there have been very strong incentives to purchase an annuity at the point of retirement. Creating greater freedom and choice in retirement will require individual consumers to consider the range of circumstances they may face, in particular relating to longevity. They will need to make informed decisions based on their personal needs and likely circumstances. For some consumers, these choices will require substantial guidance. (Paragraph 136)

16. The market is likely to adapt, offering a new range of financial products for those approaching retirement. It is crucial that these products are not defective. Were they to be so, the reputation of the financial services industry, which has suffered severe damage in recent years from large scale mis-selling, would be further tarnished. (Paragraph 144)

17. The FCA has now been given new powers to intervene early, in advance of detriment occurring. In practice, this will be extremely difficult to accomplish without creating other forms of consumer detriment. In particular, it will be essential to avoid stifling market innovation. The use of these new powers will be a major test of judgement-based regulation. (Paragraph 145)

The Government agrees the FCA's exercise of the product intervention power must not unduly stifle innovation. It is important to note that, when exercising this power, the FCA is under a duty to act in a way that promotes effective competition in the interest of consumers, so far as that is compatible with its objectives. This means, among other things, the FCA will have to consider the extent to which its actions encourage innovation, as a feature of effective competition. The requirement that the FCA have regard to statutory Principles of Good Regulation including the principles of proportionality and of the desirability of sustainable economic growth in the medium and long term, presents a further safeguard against regulatory actions which would unduly stifle innovation and growth.

The Government will also work closely with the FCA to ensure that potential innovation is complemented by high-quality impartial guidance which stimulates active and informed choices, promotes consumer awareness of scams and helps to ensure consumers are less vulnerable to mis-selling.

18. The impact of these reforms on the annuity market will only be known after a number of years. Increased flexibility and choice in retirement will only benefit consumers if an active and innovative market offers a range of products, which should include annuities, to suit individual requirements. (Paragraph 152)

The Budget reforms give people greater choice over how to access their defined contribution pension savings – this is beneficial to individuals and the reforms will also provide opportunities for industry. The Government believes that the current tax rules stifle innovation in the retirement income market, leaving pension savers with very little choice over how to spend or invest their defined contribution savings. This has contributed to consumer inertia and a lack of engagement. By increasing the choices people have at retirement, and providing them with the right support to make the choice that is right for them, consumer behaviour will change and a more competitive and dynamic retirement income market will emerge.

We are engaging with stakeholders from industry and with the regulators to ensure we design a system that allows providers to develop products that are tailored to the needs of consumers and which will allow consumers real choice in retirement. For many people, purchasing an annuity will remain the best way to secure an income in retirement. As retirement changes, many people may, for example, opt to buy an annuity later in life, allowing them to benefit from higher annuity rates or at a time that better suits their individual circumstances.

19. There is a clear distinction in financial services between regulated advice and guidance. Although what was proposed was clear in the Budget Red Book and in the consultation document, the Chancellor's Budget statement on this point could have been better phrased. (Paragraph 161)

The Government acknowledges that there is an important difference between financial advice and guidance, and it is important that consumers understand the nature of the service they are receiving. However, in the Budget speech it is important that the changes that are being made are described in straightforward, easy to understand terms: the Budget document accurately outlines the technical detail of those changes.

20. The guidance made available to consumers must explain what, if any, protection they may have in cases of poor guidance. (Paragraph 162)

The Government is considering, as part of the design of the guidance guarantee, the recourse individuals have available to them if guidance were to fall below the required standards.

21. The guaranteed guidance must be available to people well in advance of their retirement to help their decision-making. (Paragraph 165)

The Government recognises the importance of encouraging consumers to engage with retirement planning. In designing the guidance guarantee, the Government's current focus is on ensuring that everyone with a defined contribution is offered guidance at the point of retirement – that is, the point at which individuals can take advantage of the new flexibilities—in order to support consumers to navigate a new, wider set of options and make sound decisions that suit their circumstances. However the Government also recognises that individuals will want to be able to access information and guidance during their working lives and in retirement. In particular, it is currently consulting on the question of which additional measures might be necessary to ensure that guidance is available at key decision points during retirement.

22. Given that the Money Advice Service has been asked by the Treasury to play a role in developing the standards for financial guidance at retirement, it is even more important that the independent review of the MAS is completed quickly. (Paragraph 168)

The Government has launched the independent review, led by Christine Farnish, into the Money Advice Service. This will report by the end of 2014. The review has been specifically asked to take into account the Government's commitment on retirement guidance in its assessment of need for consumer advice and the role that MAS should play in meeting this need.

23. It is essential for the success of the pensions reforms that the guidance offered under the guidance guarantee is trusted by those who use it. The guidance offered under the guarantee must therefore be demonstrably impartial. It must certainly not be biased in favour of any particular product type or provider. (Paragraph 170)

Impartiality is one of the central tenets of the guidance guarantee. The Government is currently consulting on whether guidance delivered by pensions providers and schemes could be considered genuinely impartial or whether guidance must be delivered by an independent third party to meet that test. In parallel, the Government has asked the FCA (working closely with the Pensions Regulator and the Department for Work and Pensions in relation to standards for trust-based pension schemes) to coordinate the development of standards governing the guidance and a framework for monitoring compliance.

24. It will be important for the success of this policy that people receive high quality guidance. As well as being of value to the individual it will have public policy benefits. People need to be aware that while the guidance is to be free at the point of use, the costs of firms providing it will borne by consumers. It is crucial that people grasp the value of this guidance. We therefore recommend that the full average cost of the provision of the guidance by firms be estimated and disclosed to consumers. (Paragraph 173)

The Government is currently considering the funding arrangements as part of the consultation on the guidance guarantee proposals and will set out its conclusions in the Government response to the consultation before the summer.

25. The 'guidance guarantee' is not the only Government sponsored guidance being designed for pensioners or those who are approaching retirement. These schemes should operate in concert to help people make informed decisions about what is right for them in retirement. (Paragraph 178)

The Government agrees that the guidance guarantee should complement existing sources of education, guidance and advice to consumers on retirement options. As part of its consultation, the Government is engaging with a wide range of organisations which provide consumer help and guidance on retirement to inform how the guidance guarantee can best build on existing provision.

26. The Chancellor's commitment was for face-to-face advice to be available. Evidence to the Committee from a number of witnesses suggested a desire to use other channels. These will be appropriate for some customers but, in line with the Government's pledge, it is important that at least for those who choose face-to-face guidance this is provided without financial detriment to the customer. (Paragraph 185)

It is important that consumers are able to access guidance in a way that best suits their needs and preferences, including—but not limited to—face-to-face provision. The Government is committed to ensuring that the guidance is free at the point of access, regardless of the route by which individuals access it. The Government will set out a more detailed strategy for how consumers will be able to access guidance in its response to the consultation before the summer.

27. The pension reforms announced by the Government are welcome, and also transformational. Consumers will need considerable support in navigating a market which is undergoing major change and in which consumers are likely to be offered an array of new products. The Committee recommends that the proposed guidance under the guarantee observe the following principles. It should:

- **Be demonstrably impartial as to providers and type of product;**
- **Include at least an initial opportunity for face-to-face guidance;**
- **Be free at the point of use, with the costs of such provision made transparent;**
- **Make clear to every consumer exactly what is being offered, the limitations of the guidance, and what protection it gives consumers in the event of detriment;**
- **Be offered from at least 12 months in advance of the consumer's stated retirement date; and**
- **Be co-ordinated with Government-sponsored guidance relating to long-term care.**

The Government will set out the blueprint for the guidance guarantee, and the principles it must meet, in its response to the consultation, which it will publish before the summer.

28. There are risks to individuals and the wider economy if people decide to concentrate their savings in a single asset class such as residential property. Contrary to widespread perception, residential property can be a volatile asset class and prone to large falls in value. (Paragraph 195)

The Government recognises that home ownership is an important aspiration for many households and can actually serve to insulate households from any volatility in the cost of housing. However, the Government recognises that the housing market has been overly volatile in the past and that is one of the reasons for establishing the FPC. Coupled with the implementation of the Mortgage Market Review, this will ensure that we do not return to the unsustainable lending practices of the past that have driven volatility in the housing market. As noted in the answer to questions 3 and 4, above, in its June 2014 Financial Stability Report the FPC made two policy recommendations aimed at insuring against the risk of a marked loosening of mortgage underwriting standards and a further significant rise in the number of highly indebted households. In addition to housing market policy, the savings measures announced at Budget 2014 will support household saving in a wide range of assets.

29. Taken together, the changes announced in the Budget to ISAs, as well as the reforms to the taxation of defined contribution pensions at retirement, amount to a substantial increase in the flexibility available to savers. As this flexibility increases, ISAs and pensions will become increasingly interchangeable in their effect. In the light of this, the Committee recommends that the Government set out comprehensively the approach it intends to take to taxation of all forms of saving. This should include an examination of the merits of moving further towards taxing savings once, the scope for bringing closer together the tax treatment of ISAs and pensions, and the appropriateness of the present arrangements for the pension tax free lump sum. (Paragraph 205)

The Government keeps its policy towards savings under review. It welcomes the Committee’s acknowledgment that the changes to ISAs announced in the Budget substantially increase flexibility for savers. However the Government does not agree that this flexibility will result in ISAs and personal pensions becoming interchangeable. The

Government's savings policy aims to support savers at all stages of life: increased ISA flexibility will help to ensure that all savers have the freedom to save and invest in the manner they consider most appropriate for their circumstances.

Many of the changes to ISAs and savings taxation announced in the Budget have yet to be implemented; meanwhile the roll out of the Government's automatic enrolment changes—which are expected to result in around six to nine million people making new and increased retirement savings—is continuing and represents a major change for employers. The Government does not believe that it would be appropriate to undertake a wholesale reform of savings taxation whilst these changes are underway. Savers, investors, industry and employers all need to be able to absorb and respond appropriately to changes in policy and Government needs to ensure that the pace of change takes appropriate account of this.

30. The Government's announcement that National Savings and Investments (NS&I) will offer 'pensioner bonds' at a market-leading rate represents something of a departure from NS&I's usual approach. NS&I is required to balance the funding needs of the Government, its customers and the wider financial services sector. Pensioner bonds have tilted this balance—in this case at least—in favour of customers and away from the Government and the financial services sector. The Government must provide clarity about the framework within which NS&I is now operating. (Paragraph 211)

National Savings & Investments (NS&I) core remit remains the provision of cost-effective financing for the Government. Within this remit, its operating framework requires NS&I to balance the interests of its customers, the taxpayer and the wider financial services sector. Low interest rates have played an important part in supporting the recovery, which has helped taxpayers and the wider economy, including the financial services sector. But there are those—especially pensioners—who rely on a reasonable rate of interest on their savings, and this measure aims to target support at them. In recognition of the fact that the bonds are issued for specific policy aims beyond the normal debt management remit of financing the deficit in the most cost effective way, the increased costs of the NS&I product compared with financing through Gilt issuance has been included on the Budget scorecard.

31. Since the Government has decided that it wants NS&I to give priority to customer interests, we recommend that NS&I consider once again offering index-linked savings certificates. (Paragraph 212)

NS&I's core remit remains in line with the Government's overall debt management objective, to 'minimise, over the long term, the cost of meeting the Government's financing needs, taking into account risk, while ensuring that debt management policy is consistent with the aims of monetary policy'. While the Government keeps all NS&I products under review, it does not currently judge that bringing Index-linked savings certificates back on sale would be a cost effective method of financing. Budget 2014 introduced new products to provide certainty and a good return specifically to the over 65s, who rely on their savings it retirement.

32. The increase of NS&I's Net Financing Target from £2 billion, plus or minus £2 billion, in 2013–14 to £13 billion, again plus or minus £2 billion, in 2014–15 could have a significant effect on NS&I's market share. The Government must ensure that this

does not destabilise the wider savings market by crowding out private savings providers. (Paragraph 213)

NS&I always acts transparently and makes banks and building societies aware of its intentions on Net Financing so they can factor this in to their planning. This happened again this year—particularly with the intention to launch the new bond for those aged 65 and over being announced in March 2014 although it will not go on sale until January 2015.

NS&I's market share has been declining for many years and NS&I estimate that the Net Financing target of £13.0bn will represent less than 1% of the total UK savings market, which grew by £74 billion last year. The Government expects that inflows into NS&I would be split between those from existing stock and new growth. The NS&I measure should therefore not stop other institutions who want to attract deposits from doing so. In addition, the increased ISA allowance to £15,000 will allow competitors further scope to attract deposits.

Taxation

33. Retrospective tax legislation conflicts with the principles of tax policy recommended by this Committee. In our Budget 2012 Report we recommended that the Government restrict the use of retrospection to wholly exceptional circumstances. Witnesses told us that the Government was not abiding by this recommendation. Furthermore, the Red Book announced an additional retrospective taxation policy: an extension of the requirement for taxpayers to pay upfront any disputed tax associated with anti-avoidance schemes. This policy will retrospectively apply to some of the 65,000 outstanding tax avoidance cases. There may be a case for this policy but the Government has yet to explain what is wholly exceptional about these cases that justifies this retrospective measure. It should do so in response to this Report. (Paragraph 225)

The Government does not agree that this legislation is retrospective. This legislation does not take effect on a date before its announcement or enactment, and it does not change any tax liability arising from any transaction or arrangement, whether undertaken before or after the introduction of these new rules. It puts in place a new requirement that takes effect in the future, to pay over a sum of money in dispute. Those disputes will be resolved in the same manner as before, with full appeal rights to the tribunal and courts.

The Government does not therefore consider it necessary to consider the application of the Protocol on Unscheduled Announcements of Changes to Tax Law in relation to these measures.

34. The proposal to grant HMRC the power to recover money directly from taxpayers' bank accounts is of considerable concern to the Committee. It could develop into a return to Crown preference by stealth. The Committee considers a lengthy and full consultation to be essential. The greater detail provided by the Government on 6 May will need further and extensive examination, and the Committee will take further evidence on this. Giving HMRC this power without some form of prior independent

oversight—for example by a new ombudsman or tribunal, or through the courts—would be wholly unacceptable. (Paragraph 244)

35. The Chancellor argues that this measure can be justified because the Department for Work and Pensions already has the right to take money directly from people's bank accounts to pay child maintenance. However, the parallel is not exact: in those cases, DWP is acting as an intermediary between two individuals. HMRC would be acting not as an intermediary between two individuals but rather in pursuit of its own objective of bringing in revenue for the Exchequer. (Paragraph 245)

36. This policy is highly dependent on HMRC's ability accurately to determine which taxpayers owe money and what amounts they owe, an ability not always demonstrated in the past. Incorrectly collecting money will result in serious detriment to taxpayers. The Government must consider safeguards, in addition to those set out in the consultation document, to ensure that HMRC cannot act erroneously with impunity. These might include the award of damages in addition to compensation, and disciplinary action in cases of abuse of the power. (Paragraph 246)

37. The ability directly to have access to millions of taxpayers' bank accounts raises concerns about the risk of fraud and error, and this should also be covered by the consultation. (Paragraph 247)

The government is proposing to only use this power against a small core of taxpayers who are reluctant to pay, who owe significant debts of over £1,000 and have sufficient funds in their accounts. The government believes that it is unfair that these taxpayers who fail to meet their obligations have an advantage over the vast majority of taxpayers who pay on time and in full. Before HMRC uses this tool, debtors will have been contacted several times by HMRC—and will have had multiple opportunities to pay—before getting to the stage where HMRC needs to take action to recover the debt. Before this policy is applied, debtors will usually have the option of appealing to a Tribunal on the amount of tax due or on the legal basis of the liability. At any stage in the process, the debtor can contact HMRC to pay in full, agree a Time to Pay arrangement where appropriate or query the amount they owe.

The government is not introducing 'Crown Preference by stealth', which the Committee raises as a concern. Individuals or businesses with debt should get in contact as soon as possible to pay what is owed immediately or, if appropriate, set up an arrangement to pay over a longer period of time. HMRC does not have an interest in putting viable businesses into insolvency to recover the debt it is owed. The returns from doing so are often far lower than supporting a viable business through a Time to Pay arrangement, where appropriate.

As the Committee notes, the government is consulting on this measure and published a consultation document on 6th May 2014. A central aim of this consultation is to ensure there are balanced and appropriate safeguards in place so that this is only targeted at the truly non-compliant and there are strong safeguards in place to protect vulnerable members of society. This includes proposals to help ensure the policy does not create unnecessary financial trouble for those affected or lead to funds being removed that are needed for immediate and essential day-to-day living costs or business expenses. As part of this, the government is proposing to leave a minimum of £5,000 across a debtor's accounts after the debt has been recovered. This policy will also be easily reversible, allowing HMRC to swiftly remove its hold on funds once the debtor has arranged to pay what they owe, or return funds to a debtor's account where necessary.

The consultation also seeks to ensure that there are adequate checks and procedures in place to minimise the risk of errors, any mistakes are rectified quickly and compensation paid as appropriate, and that there are appropriate channels for debtors to appeal. The government is consulting widely, with a range of business and taxpayer groups, to ensure these safeguards are suitably robust and that the concerns raised by the Committee are considered in full.

38. Following the merger of HM Customs and Excise and the Inland Revenue in April 2005, an extensive review of HMRC's powers, deterrents and safeguards was carried out from 2005 to 2012. The Committee believes that sufficient time has now passed to warrant a post-implementation review of these powers. The aim of this review should be to ensure that all the powers HMRC has at its disposal remain relevant and are no more than are sufficient to enable HMRC to achieve its objectives. (Paragraph 248)

The Review led to legislation in Finance Acts 2007–2012.Not all legislation has been fully implemented and so no policy evaluation has been carried out. Although we have not undertaken a policy implementation review, a number of elements have already come under scrutiny as tax administration develops (for example, through the introduction of Real Time Information). We continue to monitor how well implemented legislation is working in practice and will take into account the committee's comments.

39. The Committee welcomes the Government's decision to reduce the starting rate of savings income tax to 0 per cent and to increase to £5,000 the band of savings income to which this rate applies. There is, however, a risk that the benefits of this measure could be eroded if those who are eligible for the 0 per cent rate do not understand that they are eligible or do not know which forms they need to complete. We urge HMRC to set out a clear plan describing how it will work and how banks and building societies will ensure that relevant savers are aware of this change. (Paragraph 254)

HMRC has published a detailed Q&A document for savers explaining how the starting rate of tax for savings income will apply from 6 April 2015. In the run up to this date, HMRC will continue to work with banks, building societies and representative groups to develop customer-focused resources that explain this tax change in a clear and accessible way, and help savers understand whether they can register for the interest on their accounts to be paid without tax deducted. Work is also ongoing with banks and building societies to ensure that the registration process for savers is as simple and accessible as possible.

40. The frequency of changes to the annual investment allowance over the past seven years has created uncertainty and instability for businesses and imposed an economic cost. The Committee has previously highlighted the importance of stability in the tax system in its 2011 Report, Principles of Tax Policy. We therefore recommend that the Treasury develop a strategy for future annual investment allowance changes to reduce the current instability and help business planning. (Paragraph 260)

The government recognises the importance of certainty and stability for businesses that want to invest. For example, in 2010 we published a Corporation Tax Roadmap designed to provide certainty and clarity to business regarding our plans to make the UK tax regime more competitive. However, the Government also needs to be able to adjust tax policy in response to wider economic trends or challenges.

Business investment is crucial to delivering a sustainable economic recovery. Investment fell markedly during the financial crisis. Business confidence is now rising, and latest figures show that investment has grown for five consecutive quarters for the first time since 1998.But there is still a long way to go before it fully recovers.

At Budget 2014 the Government doubled the Annual Investment Allowance (AIA) to £500,000 in recognition of the challenges businesses face following the biggest financial crisis in generations. The measure has been warmly welcomed by businesses who believe it will help them to bring forward and realise their investment plans. The OBR estimate that the measure will lead to just under £1bn of investment being brought forward into 2014 and 2015.

The Government takes a number of factors into consideration when making tax policy, including cost, sustainability, and the impact policy changes would have on business. All tax policy is kept under review, and tax policy changes are announced by the Chancellor at Budget or the Autumn Statement.

Parliamentary Timing

41. It is essential that the Budget and the Finance Bill receive adequate, detailed parliamentary scrutiny. Prior to 2011, it was customary for four to six weeks to elapse between the Budget and the Second Reading of the Finance Bill. In the most recent three years, this has fallen to an average of just under three weeks. We welcome the Government's provision of a full sitting week between Second Reading and Committee of the Whole House. Nevertheless, this year, the timings of the Budget and the Finance Bill have not permitted adequate scrutiny to take place—either by this Committee or outside—in time for either Second Reading or Committee of the Whole House. We therefore recommend that, in future, there should be no less than three sitting weeks between the Budget and Second Reading of the Finance Bill, and at least a further sitting week between Second Reading and Committee of the Whole House. Four to six weeks between the Budget and Second Reading of the Finance Bill was once the norm, so our proposal will simply bring the arrangements closer to the practice that pertained before 2011. We accept that it may not be possible to achieve this timetable in an election year, but it certainly should be the accepted practice at other times. (Paragraph 270)

As the Government has noted in response to previous reports from the Committee, significant steps have been taken since 2010 to improve opportunities for scrutiny of the Government's legislative proposals, including publishing the majority of Finance Bill clauses in draft at least three months ahead of publication of the final Bill. Such an approach has resulted in far greater consultation and external scrutiny than was the case before.

The Government recognises that longer intervals between publication of the Bill and Second Reading and between Second Reading and Committee of the Whole House would be desirable. Subject to the constraints of the Parliamentary timetable, the Government will continue to look for opportunities to improve scrutiny where possible.

Appendix 2: Office for Budget Responsibility Response

I am writing in response to the Committee's report on Budget 2014. You had two main recommendations regarding the work of the OBR:

- First, "it is important that the OBR cost the long term implications of Budget measures", and;
- Second, "that, when Budget announcements are not submitted before the OBR's deadline, the OBR should scrutinise major uncosted policies as soon as reasonably possible thereafter and publish its findings".

Costing the long-term implications of Budget policies

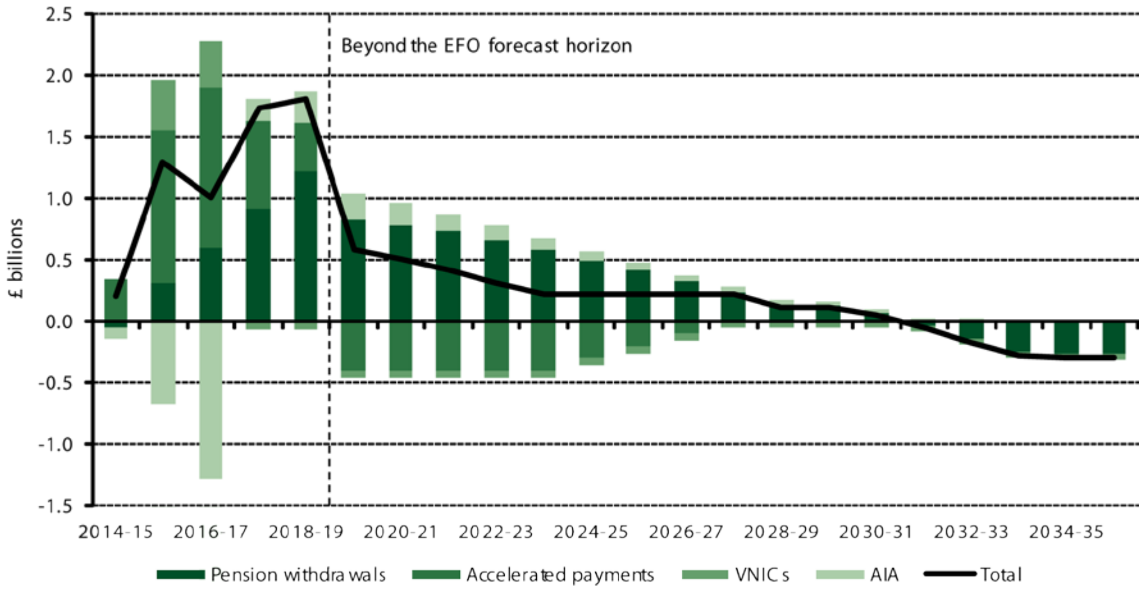
We very much agree that it is important to highlight the long-term impact of Budget policy measures on the public finances, especially where this differs significantly from the impact over the usual five-year forecast horizon. As you noted in your report, we highlighted four such policies in the March *Economic and Fiscal Outlook*:

- the pension withdrawals measure, which brings forward income tax receipts but has a small steady-state cost in the long term;
- voluntary NICs, which increases NICs receipts in the short term but also increases long-term state pension costs;
- the temporary annual investment allowance increase, which raises the amount of tax relief that can be claimed until December 2015, but then reduces it thereafter, largely recouping the scorecard costs, and;
- accelerated payments related to tax avoidance schemes, which brings forward receipts from future years.

As we illustrated in the EFO, and as you noted in your report, the net effect of these measures is to increase receipts over the scorecard horizon by £1.2 billion a year on average, but the revenue raised then drops sharply in 2019–20 and averages only £0.2 billion a year over the 15 years beyond the scorecard horizon.

Given the uncertainty associated with costing these policy measures over a 5-year horizon, the longer-term implications will also be subject to considerable uncertainty.

Figure 1: Revenue raised by selected Budget policy measures



Source: HM Treasury, OBR

We are glad that you found this analysis useful, and I can confirm that we will produce similar analysis at future fiscal events if confronted with policy decisions that have similar implications.

Costing of policy decisions submitted after agreed deadlines

We share your frustration that the Government did not inform us of the decision to extend childcare support to all families on Universal Credit (and not just those paying tax) in time for us to scrutinise and certify the costing in the March *Economic and Fiscal Outlook*.

As I noted at our press conference following the Budget statement:

> "The Government claims that the cost of this measure will be around £200 million a year. It would have been much better for this costing to have been subjected to proper scrutiny and to be included in our forecasts, along with every other policy measure that affects the public finances. To say that the cost to the Exchequer will be offset later by some as-yet-unidentified changes to Universal Credit is no excuse. We will look at this measure, and any accompanying measures, very closely in the run-up to the Autumn Statement."

But while I am disappointed that the Government chose to announce an uncosted and unscrutinised policy in this way, I would not in general wish to publish costings for such announcements between fiscal events—as I fear this would only encourage the Government to repeat the offence. It might also encourage it to exploit our costing function in other ways, for example by asking us to publicly endorse the costing of policy announcements during party conferences.

Agreeing firm and transparent deadlines with the Government—and then sticking to them—is essential to the integrity of the forecast and policy costing process, and of our assessment of progress against the fiscal rules. It means that our EFO forecasts can be trusted as comprehensive assessments of the totality of announced Government policies, not just a subset of the Government's choosing. I would not want to institutionalise an arrangement in which the Government could announce policies at high-profile fiscal events and then have the costings dribbled out over succeeding weeks, when public attention has moved on and after your committee has finished taking evidence from us and the Treasury on the fiscal event in question.

At the end of the day, it is of course for the Government to decide whether to behave in this way—and there will doubtless be occasions when late policy announcements are unavoidable. As we have said in the past: "We do have some flexibility to adjust the final forecast for late policy decisions and economic information emerging closer to publication. But it is clearly in everyone's interests that, wherever possible, policy decisions are taken in a timely way that facilitates adequate scrutiny and incorporation in the full-scale forecast."[1]

I hope that the committee will join with us in encouraging the Government to stick to the deadlines that it agrees with us—and will continue highlighting the regrettable occasions on which it does not.

[1] http://budgetresponsibility.org.uk/wordpress/docs/OBR-response.pdf